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ABSTRACT : *The 2007 financial crises has brought to eminence and a long overdue recognition to the ideas of Hyman. P Minsky who is a post-Keynesian authority on monetary theory and financial institutions. He had extensively[1] studied the economic fluctuations and recurring instability of the financial system in a capitalist economy in an attempt to understand and explain the characteristics of financial crises. Many analysts believe that Minsky's framework of analysis has accurately anticipated the financial crisis of 2007 and termed it as the Minsky moment. His financial instability hypothesis (FIH) rejected the mainstream economic concepts of the efficient market theory which believes that force of invisible hands keep the markets clear. Minsky observed that periods of financial instability are common and it is the government's massive interventions since the World War II which has contained their effects. In the aftermath of financial meltdown of 2007, many financial analysts e.g. Magnus 2007; McCauley, 2008 and economists like Kregel 1997, 2008; Papadimitriou and Wray 2008; Passarella 2010; Tymoigne and Wray 2008; Vercelli 2001, 2009a ,Wray 2008), Damiano Silipo 2010, have referred to the contributions Minsky as fundamental to understand the tendency of capitalistic economies to fall into recurring crises and for a consistent policy design . Minsky believed that regulation should be linked to the structure of the financial system and effective policy making requires an understanding of the dynamics of an accumulating capitalist economy. These policies would have to constrain instability through creation of institutional ceilings and floors while at the same time they would have to address the behavioral changes induced by reduction of instability. Minsky's proposals go far beyond the 'invisible handwaves' of free market ideologues.*

[1]The economic crisis of the 1970s and 1980s and the crisis of economic theory and policy that accompanied it may have come as a surprise to most of the profession, but Professor Minsky would have been surprised if such crises failed to materialize. There are two key building blocks in Minsky's work on capitalist instability: his theory of investment and his theory of profit determination. They also constitute the foundation for his conclusion that the financial sector is the exclusive source of instability in a capitalist economy.

Introduction:

The 2007 financial crises generally believed to have been ignited by the collapse of the subprime mortgage market, has brought to eminence the ideas of Hyman. P Minsky who is a post-Keynesian authority on monetary theory and financial institutions. When the mainstream of the economics profession was almost unanimously celebrating the demise of the business cycle and the commencement of uninterrupted economic prosperity in the mid-60s, Minsky urged about the endogeneity of cyclical instability and the transitory nature of the institutional underpinnings of financial markets[2]. He had extensively[3] studied the economic fluctuations and recurring instability of the financial system in a capitalist economy in an attempt to understand and explain the characteristics of financial crises. Many analysts believe that Minsky's framework of analysis has accurately anticipated the financial crisis of 2007 and termed it as the Minsky moment. His financial instability hypothesis (FIH) rejected the mainstream economic concepts of the efficient market theory which believes that force of invisible hands keep the markets clear and stable always, rather Minsky argued that successful containment of instability led to the evolution of fragile financial structures which result in renewed financial crisis. The problem as Minsky viewed it is that the institutional reforms have not evolved to keep pace with innovations that make it more likely that "*it*" might happen again.

The role of uncertainty in macroeconomic models, its effect on the stability of the economy, nature of regulatory superstructure and the role envisaged for fiscal and monetary policy in the period of and after the financial crisis are the themes around which I have defined and characterize the research questions for my PhD dissertation which *"investigates the genesis of the financial crises of 2007, it affects on emerging markets economies and shape of the regulatory framework required to have more stable financial markets"*. The existence of the interrelationships between finances, investment and economic fluctuation is one of the key features of contemporary market economies. Analyzing these interrelationships requires the careful study of various and often intricate questions to which Minsky was as an economist[4]. Underlying the financial dynamics implied by the FIH, Minsky's financial theory of investment, associated with his analysis of financial fragility and endogenous instability can be found. This aspect of his analysis is fundamental obviously because it makes Minsky's approach specific and original in comparison to the traditional macroeconomic analysis. It is also the paramount feature of his work to attract the attention of writers and policy makers in the wake of recent events of 2007 meltdown. The collapse of the sub-prime market in 2007 has been broadly labeled as *"Minsky moment[5],"* (Cassidy 2008; Chancellor 2007; McCauley 2007; Whalen 2007) followed by the subsequent implosion of the financial system and deep recession which is seen as the confirmation of FIH. Financial (and government) authorities all around the world implemented set of policies to contain the catastrophe but somehow a suitable analysis of the FIH remained missing which can point out the weaknesses of the dominant market-oriented monetary and financial regulatory framework. For in-depth comprehension of this issue a Minskian approach of the economic instability resulting of cumulative euphoric expectations can be used as theoretical guideline which distrusts the orthodox beliefs about the self-regulation of market mechanisms to

[2] Marx, Keynes, and Minsky on the Instability of the Capitalist Growth Process and the Nature of Government Economic Policy James R. Crotty: 1986

[3] The economic crisis of the 1970s and 1980s and the crisis of economic theory and policy that accompanied it may have come as a surprise to most of the profession, but Professor Minsky would have been surprised if such crises failed to materialize. There are two key building blocks in Minsky's work on capitalist instability: his theory of investment and his theory of profit determination. They also constitute the foundation for his conclusion that the financial sector is the exclusive source of instability in a capitalist economy.

[4] His main achievement was the conception and elaboration of the financial instability hypothesis, the notion that embraces three important aspects; a financial and dynamic dimension; a particular view of the behavior of economic agents in situation of uncertainty and an institutional dimension

[5] Paul McCulley, an economist and bond fund manager at Pacific Investment Management is said to have coined the term "Minsky moment" during the Russian debt crisis of 1998

correct judgmental errors of private agents without imposing collective regulation (Ulgen, 2010). A Minskian lecture of the financial turmoil in the aftermath of 2007 events would lead monetary and financial authorities to carve out more consistent policies.

In this aim this paper based on the chapter of a thesis is divided in to 4 sections. First section briefly describes the importance of financial stability for the real economy. Section two covers the state of the art literature review about the FIH as an explanation for financial crises. Section there gave a comparison is between FIH and efficient market hypothesis. Fourth section draws on Minsky's views as a guideline for regularity response. Fourth section concludes.

1; Financial Markets, Financial Stability and Real Economy. The role of finance and financial markets in economic growth and its connection with stability and crisis have received immense importance from researcher and policy makers in last three decades. Consequently the imperative of understanding these interrelationship vis- a- Vis a policy formulation for future prevention of the recurrences of financial crises and resulting recession are transcendentally important issues.[6] A synthesis[7] of Marx's monetary ideas, Keynes's ideas developed in his *General Theory,* Schumpeter's thesis of *creative destruction,* Charles Kindleberger's analysis of displacements in *Manias, Panics, and Crashes*[8] and Minsky's *financial instability hypothesis* suggest an appropriate theoretical framework for investigating the role of finance in economic and financial instability and development of financial crisis in capitalistic economies. Keynes's (1936) and Minsky's historical and institutional (1977; 1982a; 1982b; 1986, 1992) analyses suggest a brilliant and deep understanding of the impact the monetary and financial system has on industrial performance and the functioning of a market economy in the context of an uncertain and changeable environment. Minsky observed that periods of financial instability are common and it is the government's massive interventions since the World War II which has contained their effects. He criticized the monetarists for narrowly defining the financial crises and limiting these only to bank panics (Schwartz 1988, 1998), and rejecting the events that would have been catastrophic if the government had not intervened (Sinai 1976; Minsky 1986; Mishkin 1991).

Financial Crises of 2007 is now well into its third year. All sorts of explanations have been proffered for the causes of the crisis, from lax regulation and oversight to excessive global liquidity. Unfortunately, these narratives do not take into account the systemic nature of the global crisis and the evolution of financial markets in last two decades. Nevertheless Minsky's analysis correctly links postwar developments with the prewar "finance capitalism" analyzed by Rudolf Hilferding, Thorstein Veblen, Keynes and later by Galbraith. Financial markets have developed to its apex and have served as the driver of growth in the last two decades and consequently the subject of preserving financial stability is receiving immense importance both in advanced and EMEs countries. Financial stability designates the condition that ensures smooth financial intermediation and the confidence that key financial institutions and markets are operating well. Financial instability on contrary can be very costly due to its contagion or spillover effects to other parts of the economy. Indeed, it may lead to a financial crisis with

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[6] "Financial Market Regulation in the Wake of Financial Crises: The Historical Experience" Edited by Alfredo Gigliobianco and Gianni Toniolo, *the Banca d'Italia series* Workshops and Conferences.

[7] Finance, Instability and Economic Crisis: The Marx, Keynes and Minsky Problems in Contemporary Capitalism By George Argitis (2003)

[8] This approach views financial crises as the culmination of a process that does not inevitably lead to a crisis but often may because the dynamics of belief (called adaptive expectations), financed by excessive credit creation, often result in speculative excesses or manias. Kindleberger does not blame markets per se for creating the circumstances in which irrationality can take over—on the whole he regards markets as generally efficient but often in need of help. His view is distinct both from the free marketers who regard markets as always rational and efficient and the hyper-regulators who believe that markets work badly most of the time and need intense government oversight.

adverse consequences for the real economy. Hence, it is fundamental to have a sound, stable and healthy financial system to support the efficient allocation of resources and distribution of risks across the economy. Stability in the financial system would be demonstrated by an effective regulatory infrastructure, effective and well-developed financial markets and sound financial institutions. To achieve the objective the authorities relies on market forces to the maximum possible extent with a faith that any of its actions to contain systemic risk should be at the minimum level required to be effective (Ulgen 2008). Conversely, it could manifest through bank failures, intense asset price volatility or a collapse of market liquidity and, ultimately, in a disruption in the payment and settlement system. The conventional economic wisdom postulates that the economy is naturally stable, with the invisible hand guiding the economy always to equilibrium path. Shocks might temporarily move the economy away from equilibrium, but the forces that move us back to equilibrium are strong. Financial markets dislike Cassandra's and use of the contemporary economic theory as the basis for policy formulations drips the idea that markets equilibrium is just a transitory period (Riccardo Bellofiore and Joseph Halevi, 2009) Rather than viewing institutions as contributing to stability, orthodoxy views institutions as barriers to achieving equilibrium. In contrast, Minsky's vision, insists that "institutions and interventions thwart the instability breeding dynamics that are natural to market economies by interrupting the endogenous process and 'starting' the economy again with non-market determined values as "initial conditions". (Minsky and Ferri, 1991, p. 4).

2;Key Literature Review on The Minskian Analysis of Financial Crises & Instability in Capitalistic Economy; In the last few years and particularly in the aftermath of financial meltdown of 2007, many financial analysts (Magnus 2007) and economists like Kregel 1997, 2008; Papadimitriou and Wray 2008; Passarella 2010; Tymoigne and Wray 2008; Vercelli 2001, 2009a ,Wray 2008), Damiano Silipo (2010), have referred to the contributions Minsky as fundamental to understand the tendency of capitalistic economies to fall into recurring crises. In fact, according to many observers, both the 'dot-com' crash of 2000-02 and the burst of the so called 'subprime housing loan' crisis at the beginning of 2007 would confirm many of Minsky's forecasts: from the growing financial fragility of the economic system as the result of a previous period of 'tranquil growth' to the risk of a credit crunch and a widespread debt deflation; from the gradual loosening of safety margins to the reduction in the time elapsing between one crisis and another. Minsky saw modern capitalism as an inherently unstable system governed by the behaviour of private investment (Marc Lavoie and Mario Seccareccia, 2000), endogenized finance and pointed to the dynamic interaction of financial sector with industrial sector as the source of that endogenous instability (Dymski and Pollin 1992, p38) and institutional dynamic of the business fluctuations (Nasica Eric, 2000). We reassess these works in the following section for the better understanding of the relevance of Minsky's framework to the crises of 2007.

a)NASICA Eric, 2000: "*Finance, Investment and the Economic Fluctuations: An analysis in the tradition of Hyman Minsky*"; to examine how financial factors could be more appropriately introduced into the analysis of economic fluctuations, the line of research initiated by Minsky at the end of 1950s is quite relevant. Minsky developed an approach where the role of uncertainty and the behaviour it generates, the dynamic instability of market economies, the role of money is duly recognized. Minsky constructed an original business cycle theory known as FIH[9], essentially an important contribution in an attempt to propose a true explanation about the working of contemporary macroeconomics. His approach rests upon an endogenous and financial conception of the economic fluctuations which is completely in contradiction with the vision of self -regulating and constantly in- equilibrium economy depicted by the new classical economists. Another central aspect of Minsky's approach is the institutional dimension of economic

[9] sometimes known as Wall Street paradigm

fluctuations. In his theory institutional factors such as public authority's interventions affect the nature of the business cycle in way that is ambivalent. Institutions act as "thwarting systems" whose purpose is to counteract and contain the naturally explosive amplitude of economic fluctuations. Thus they themselves become factors of instability and inefficiency. For Minsky the various institutions function is to slow down and adjust the dynamics process at the origin if the economy's endogenous and incoherent behaviour. This situation calls for introducing on a sustained basis a new initial condition into the system which modifies the behaviour of the markets and alters the parameters affecting economic agents' decisions. In short the institutional character of the analysis provides a relevant theoretical framework for understanding the role of stabilizing institutional mechanism that are present in financially sophisticated economies.

b)Dimitri B. Papadimitriou and L. Randall Wray; 1999, *"Minsky's analysis of financial capitalism"* presented a very informative analysis of Minsky's theory. They argue that Minsky's analysis always concerned "modern" capitalism which can also be pronounced as financial capitalism because of the important role played by financial arrangements in this sort of economy. The New Deal and postwar reforms successfully constrained the natural instabilities of financial capitalism for a longer time but is very successful containment of instability led to the gradual buildup of fragile financial structures paving the course for renewed financial crisis. The problem as Minsky see it, is that the institutional reforms have not progressed to keep pace with innovations that make it more likely that "it" might happen again. Authors also assert that the propensity to runaway speculative boom has increased in the last two decades pointing towards the savings and loan fiasco in the US during the 1980s, to the mid-1990s Asian "tiger" financial crisis, and to the late 1990s US stock market boom as examples of speculative excesses-- a point truly recognized by Minsky in his analysis

c)Tymoigne E. and Wray L.R. (2008) *"Macroeconomics meets Hyman P. Minsky: the financial theory of investment*" authors argued that the current financial crisis undoubtedly provides a persuasive cognitive to show how Minsky's approach offers the sound grounding in the workings of financial capitalism. The collapse of subprime housing loans and resulting financial crises has also earned a long overdue recognition for Minsky. Minsky developed an alternative to the standard approach developed in the early 70s, based on the "*efficient markets hypothesis*" that relegates money and finance to the sidelines. Minsky strongly believed that such theory is irrelevant to serve the requirements a modern capitalist economy which is comprised of complex, expensive, and long-lived capital assets and emphasized that instability is a normal result of modern *financial* capitalism (Minsky 1986: 101, 250). Further, stability cannot be maintained permanently even with appropriate policy[10]. Minsky argued that the relative stability of the post-war period had led to development of Money Manager Capitalism; a much more unstable version of modern capitalism. In a prescient paper written in 1987 Minsky predicted the explosion of home-mortgage securitization. Minsky argued that the long depression-free period that followed WWII created a global glut of managed money seeking returns. The importance of banks was rapidly eroded in favor of "markets" in post war era. Gradually this development was further encouraged by the experiment in monetarism (1979–82) which decimated the regulated portion of the financial sector in favor of relatively unregulated "markets," and the continual erosion of the portion of the financial sphere that had been ceded by rules, regulations, and tradition to banks further spurred this trend. Now financial markets had the advantage of operating with much lower spreads due to exemptions from required reserve ratios, regulated capital requirements, and certain costs of relationship banking. Financial markets were also remained out of the spheres of the New Deal regulations which made them more safer which

[10] For this reason, Minsky rejected "Keynesian" policy that promoted "fine-tuning" of the economy—even if policy did achieve transitory stability, it would set off processes to reintroduce instability. Hence, "[t]he policy problem is to devise institutional structures and measures that attenuate the thrust to inflation, unemployment, and slower improvements in the standard of living without increasing the likelihood of a deep depression" (Minsky 1986: 295).

simply means that larger chunk of financial sector was actually free of most regulation. All of this greatly increased fragility of the financial system which eventually ushered into subprime loan crises in the USA.

d) Dimitri B. Papadimitriou and L. Randall Wray, 1998: "*The Economic Contribution of Hyman Minsky: Varieties of Capitalism and Institutional Reform,":* Minsk's analysis concerned an evolving, developed, big-government capitalist economy with complex and long-lived financial arrangements. These essay summaries the Minsky's early work, including his well-known financial instability hypothesis and his policy proposals designed to reform the financial system. Accordingly during the 60s, Minsky developed the FIH in an attempt to answer the question *"can it happen again"*. Minsky continuously argued that *"stability is destabilizing"*. FIH postulates that the economy has financing regimes under which it is stable, and financing regimes in which it is unstable and over periods of prolonged prosperity, the economy transits from financial relations that make for a stable system to financial relations that make for an unstable system' (Minsky, 1992c, p 7-8). Minsky argued 'The policy problem is to devise institutional structures and measures that attenuate the thrust to inflation, unemployment, and slower improvements in the standard of living without increasing the likelihood of a deep depression. His policy recommendations were designed to promote a successful form of capitalistic model within these financial arrangements. According to him policies would have to 'constrain' instability through creation of institutional 'ceilings and floors' while at the same rime addressing the behavioral changes induced by reduction of instability.

e) Vercelli Alessandro (2009) "*A Perspective on Minsky Moments: The Core of the Financial Instability Hypothesis in Light of the Subprime Crisis*" This paper aims to help bridge the gap between theory and fact regarding the so-called "Minsky moments" by revisiting the "financial instability hypothesis" (FIH) and tried to clarify and develop the core of the FIH in the light of recent financial crises. Vercelli has limited his analysis to FIH's financial part strictly and builds on a reexamination of Minsky's contributions in light of the subprime financial crisis of 2007. Author began with some constructive criticism of the well-known Minskyan taxonomy of hedge, speculative, and Ponzi financial units and suggested a different approach that allows a continuous measure of the unit's financial conditions. He argued that the Minsky process is nothing but a well-defined phase of a financial cycle that may be well explained by the core of the FIH. He has shown that each cycle is part of a sequence of financial cycles with its particular characteristics that depend on the structural features of the economy and the prevalent policy strategies. To mitigate the financial cycle some policy insights can be dawn e.g.; stricter capital requirements of units and constraints on illiquidity and indebtedness useful stabilize the economy. Implementation these policies are very important and financial authorities should enforce rules regardless of the cycle phase. Minsky frequently repeated that the only effective stabilization measures are those that intervene much before the first serious stress symptoms emerge[11].

f) Damiano B. Silipo (2010), *"It happened again :A Minskian analysis of the subprime loan crisis"* The advanced countries are now going through the worst crisis since the Depression, but Silipo in his article posits that today's dominant current theories and econometric models failed to predict the crisis of 2007 . Thus the paper investigates whether the financial instability hypothesis of Hyman P. Minsky offers a better explanation despite the fact that Minsky's theory is a more general, offering a financial explanation of the business cycle. Minsky argued that in a period of economic growth and tranquility economic agents are more prone to risk taking resultantly banks are more willing to finance risky borrowers even. Gradually

[11] All the other extemporaneous stabilization measures, though often unavoidable, may ease the situation in the short period only at the cost of sowing the seeds of higher instability in the future.

in the course of the boom over-indebtedness and financial innovations create more fragility in the financial system leaving it exposed to adverse effects. Minsky explanation truly describes the events of 2007 and authors have shown that the main determinants of the crisis have been the increasing appetite for risk and financial innovations. However there is one difference: in Minsky's analysis of the business cycle (ideal type boom/bust), key players are banks and firms but in the 2007 crisis the central role was played by households, not firms. Nevertheless as Minsky hypothesized, financial institutions failures and securitization did play a crucial role in transforming difficulties of borrowers in to systemic crises. This led them conclude that, although this crisis differs in some of its features from previous crashes and from Minsky's analysis but, the mechanisms underscored by Minsky were and are at work.

g) Whalen Charles, 2008 "*Credit Crunch: A Minsky Moment*" This paper validates the credit crunch of 2007 as the Minsky moment. Whalen is very vocal in stressing that pulling out Minsky's ideas only during a crisis, then letting them fall back into obscurity when the crisis fades, does a disservice to his contributions, which continue to speak to us in meaningful ways about the financial system and economic dynamics. He argued that ***it*** is possible to identify some of the key elements that must play a role in a Minsky specific explanation of the 2007 credit crunch. After the bursting of "dot-com" bubble at the beginning of the new millennium, real estate seemed the only safe heavens of investment furthered by a loose monetary policy and low interest rate environment by the Fed. It was the time when lenders very creatively enticed increasingly less creditworthy home buyers into the market with exotic mortgages—for example, "interest-only" loans and "option adjustable rate" mortgages ect. The new players of the un regulated strata of the mortgage markets took the alluring opportunity to promote new products because they were highly profitable for banks, which in turn offered the brokers high commissions. Whalen has explained that securitization of mortgages meant that bankers bundled dozens of mortgages together and sliced them and then sold the bundles to investment funds such as hedge funds, which in turn used these mortgage bundles as collateral for highly leveraged loans.in his opinion fragile regulatory environment led the buildup of the subprime fiasco which later on turned into a systemic risk and whole sale financial crises.

h) Randall Wray 2008; "*Financial Markets Meltdown. What Can We Learn from Minsky?*: it's a norm now to use Minsky's financial fragility hypothesis to explain the current crisis. Minsky hypothesized that the structure of a capitalist economy becomes more fragile over a period of prosperity. Wray expressed that the belief that the world is now more stable and less vulnerable to "shocks" (the "Great Moderation") encouraged greed in place of fear of risk. In an historical analysis Wray has explained about the origins of the current turmoil can be traced back to the period of relative stability when the policies deregulation accompanied by lax oversight, and evolution of risky innovation sown the seeds of the current turmoil. Wray asters that irrational exuberance of the 1990s (based on the beliefs of the new economy) and unprecedented real estate appreciation validated the risky Ponzi finance in the 2000s, is the result of long-term, policy-induced, profit-seeking financial innovations. Wray draws lessons from Minsky's work that could be used to reformulate a consist policy to deal with the present crisis. . As Minsky put it, "A financial crisis is not the time to teach markets a lesson by allowing a generalized debt deflation to 'simplify' the system." Accordingly a more sensible model of enhanced oversight of financial institutions must put in place to ensure stability of the system. To stabilize interest rates, maintain direct credit controls, and strengthen its supervisory and regulatory functions monetary policy must be conducted in due accuracy.

i) Fernandez, Luisa, Kaboub, Fadhel & Todorova, Zdravka; 2010*"Inequality led financial stability: A Minskian Analysis of the Subprime Crisis.* This paper use Minsky's financial instability hypothesis as an analytical framework for the understanding the subprime mortgage crisis of the 2007 and calls for introducing adequate reforms to restore economic stability. After the subprime crises large number of post Keynesian and Institutionalists pointed towards the relevance of FIH to the crises. Authors argued that the subprime crisis has structural origins that extend far beyond the housing and financial markets. They believe that he rising inequality since the 1980s formed the breeding ground for the current financial markets meltdown. Current situation is only the manifestation of the ingenuity of the market system in taking the advantage of moneymaking opportunities, regardless of the consequences. The so-called "democratization of homeownership" rapidly turned into record-high delinquencies and foreclosures resulting in the catastrophe known as the subprime crises. The sudden turn in market expectations led investors and banks to re-evaluate their portfolios, freezing the liquidity in the system which eventually resulted in a credit crunch and widespread economic instability. Authors have criticized the role of Monterey authorities and government because they believe that the Fed's intervention came too late and ended in complete fiasco to usher in adequate regulation.

3; Financial Instability versus The Market Efficiency[12]: A Minskyian Perspective:

A core concept of conventional finance is the "*efficient market hypothesis.*" which articulates that even if individual decision makers get asset prices or portfolio values wrong, the market as a whole gets them right i.e. as a group, investors and lenders are not subject to risks of overconfidence . Thus the play of invisible hand keeps the market in equilibrium. Minsky believed otherwise and argues that the financial structure of a capitalist economy becomes more and more fragile over a period of prosperity. Following section draws on the comparative analysis of FIH and EMH.

3.1; *Efficient Market Hypothesis (EMH)*[13]: The EFH stipulates that all of the available information that is relevant to the price of an asset is already embodied in that price. Formally stated as "*in an informationally efficient market, price changes must be unforcastable if they are properly anticipated"* was put forward and proved by Paul Samuelson in 1965, subsequently explored in studies undertaken by Eugene Fama in 1991 and others. This hypothesis assumes that an invisible hand driven by some set of prices which always reflects the underlying fundamental value of financial assets. Accordingly market economy should keep free of government intervention and regulation. The more it would be free with minimum involvement of government, the more stable it would come out. Mantra is that freer it is, more stable it would be. Based on this ideology a grand experiment of the laissez-faire utopia conceived by the neoclassical school was performed globe wide and later on translated in the free financial markets liberalization. A brief description of this ideal state of affairs in the financial markets would be good a reminder here. There three key prices i.e. the wage rate, the exchange rate and interest rate and the macroeconomic trends are determined by these[14].Now of these three central prices, two prices, the respective currency's external value and the interest rate levels are formed in financial markets. In this context the significance of financial markets in the in terms of a country's macroeconomic development can hardly be overestimated. The traces go back to Léon Walras and his theory of exchange and theory of capital, in which decision situations under certainty are discussed and equilibrium solutions are demonstrated. This Walrasian concept of equilibrium is at the heart of what is described as market fundamentalism or in other words neoclassical orthodoxy has been passed on to the financial markets. The Walrasian equilibrium economy is based on the precondition of certainty, but this is not applicable to financial markets where prevailing uncertainty is a visible feature. In this situation financial market protagonists best can do is to

[12] This section recalls the main debate between the EFM and FIH of Minsky to point out the sources of the instability and assess the main mechanisms in both models to correct these instabilities.

[13] http://www.google.com/hws/search?hl=en&client=dell&channel=us-psp&ibd=&q=efficient+market+hypothesis+and+current+financial+crises&Submit=Google+Search

[14] Inefficient markets: causes and consequences by Wolfgang Filc

form conditional expectations in respect of an uncertain future. In 1970's Eugene Fama enters the debate and inferred that the restrictive assumptions of the Walrasian equilibrium model are not needed in order to arrive at the conclusion that prices and yields in financial markets are fair and reasonable and in other words represent efficient solutions. The consequence in terms of economic policy was that the state was to largely refrain from exerting any influence on the happenings in the financial markets, and deregulation and liberalization become the order of the day. Obviously led to economic policy adhered to these principles, dropping of the Bretton Woods system, the liberalization of capital movements, and the deregulation in financial market are manifestations of this policy. In those heydays of EMH, it was hailed by academic economist and financial analysts with general believe that securities markets are extremely efficient in reflecting information about individual stocks and market stocks and the stock market as a whole (Burton G. Malkiel, 2003). Fama concluded that there is no important evidence to suggest that prices do not adjust to publicly available information, and only limited evidence of privileged access to information about prices.[15] The adherents of the financial liberalization position also posits that financial markets left to their own devices are inherently stable and robust financial markets possess endogenous forces which achieve and maintain stability and even successfully reestablish it if initial equilibrium is disturbed. However these beliefs come under sever test in the East Asian currency crises in the late 90s and showed some unraveling but it is the meltdown of 2007 that has brought its collapse. Nevertheless once the standard reference in macroeconomics known as *"neoclassical synthesis"* has gradually become less influential over the past 25 years and is severely questioned after the financial meltdown of 2007. Current crises show that there is no longer any justification for the reliance on consistently correct price signals. The idea of unrestricted price information (which has hitherto been the basis for deregulation of financial markets) has failed completely to process information efficiently. An inconvenient truth about capitalism is that efficiency and stability cannot be achieved simultaneously

3.2; Minsky's Financial Instability Hypothesis (FIH). **[16]** The starting point of Minsky's theory was the rejection of the neoclassical synthesis. According to Minsky's theory, the financial structure of a capitalist economy becomes more and more fragile over a period of prosperity. During the buildup, enterprises in highly profitable areas of the economy are rewarded substantially for taking on increasing amounts of debt, and their success encourages similar behaviour by others in the same. Increased profits also fuel the tendency toward greater indebtedness by easing lenders' worries that new loans might go unpaid (Minsky 1975). Minsky fleshed out aspects of the FIH that come to the fore during an expansion. One of these is evolution of the economy (or a sector of the economy) from what he called "hedge" finance to "speculative" finance and then in the direction of "Ponzi" finance. In the so-called *hedge case*, borrowers are able to pay back interest and principal when a loan comes due; in the *speculative* case, they can pay back only the interest and therefore must roll over the financing; and in the case of *Ponzi finance*, companies must borrow even more to make interest payments on their existing liabilities (Minsky 1982, p22-23, p66-67, p105-106; and Minsky 1986a, p206-213). The FIH stresses that lending as an innovative, profit driven business (Minsky 1992b, p. 6). Both the evolutionary tendency toward Ponzi finance and the financial sector's drive to innovate are easily connected to the recent situation in the U.S. home loan industry, which has seen a rash of mortgage innovations and a thrust toward more fragile financing by households, lending institutions, and purchasers of mortgage backed securities. The expansionary phase of the FIH leads eventually to the Minsky moment. As Minsky writes, "Whereas experimentation with extending debt structures can go on for years and is a process of gradually testing the limits of the market, the revaluation of acceptable debt structures, when anything goes wrong, can be quite

[15] http://en.citizendium.org/wiki/Financial_economics

[16] The current financial crisis, monetary policy and Minsky's structural instability hypothesis. D. Tropeano Quaderno di Dipartimento n. 60, Aprile 2010
http://webhouse.unimc.it/economia/repo/quaderni/QDief60-2010.pdf

sudden" (Minsky 1982, p67). Without intervention in the form of collective action, usually by the central bank, the Minsky moment can engender a meltdown, involving asset values that plummet from forced selling and credit that dries up to the point where investment and output fall and unemployment rises sharply. This is why Minsky called his FIH "a model of a capitalist economy that does not rely upon exogenous shocks to generate business cycles" (Minsky 1992b, p6-8)

4: Minsky's Vision; A Guideline for Financial and Regulatory Reforms:

Although Minsky's framework certainly shed some light on ways of stabilizing the financial cycle of the economy and policy insights to have stable financial structures in a market oriented economy. His analytical approach was based on the development of regulatory reforms required to manage instability. In his book "*stabilizing an unstable economy"*, Minsky offered an agenda for reform that focused on four main areas: big government, employment strategy, financial reform and the market power. This section is focused to highlighting briefly his vision of reforms related to financial crises and the resulting instability. It can be argued that best solution is the prevention of the crises but that requires vigilance. Galbraith argued since long that market mechanisms are losing their authority as a regulatory force in America. He suggested that economists "are faced with a three-way choice." One possible response is "to deny that anything much has happened to the market." Another is "to accept that the market has declined but to believe that it can be retrieved." The third is "to accept the decline of the market" and "address oneself to considering how the resulting economic performance can be made socially acceptable to as many people as possible[17]" (Galbraith 1978, p. 8-11). However Minsky believed that regulation should be linked to the structure of the financial system [18] and effective policy making requires an understanding of the short and long term dynamics of an accumulating capitalist economy[19]. In this aim he saw the need to develop theories that improve the understanding of these both type of dynamics. Forming and updating such theories should be the primary mission of modem economic theory (Ferri and Minsky 1992, p89; Fern and Minsky 1989, p124; Minsky 1993a). By the 90s, Minsky was thoroughly convinced about the necessity of essential institutional reforms within both the financial system and the broader economy.

Minsky was completely aware of the flawed nature of unregulated macroeconomic activity and this compelled him to introducing an alternative to neoclassical theory in the early 90s. Institutional structure of a capitalistic economy is the fundamental determinant of the path of development because it is this structure that facilitates influences, regulates, and constrains economic activity. Minsky also stressed the dynamic nature of the institutional structure and his alternative policy proposals in the 90s were designed to promote stability though institutional dynamics. Minsky had no faith in automatic equilibria by the market participants thus he saw the necessity for state intervention. *"To contain the evils that market systems can inflict, capitalist economies developed sets of institutions and authorities, which can be characterized as the equivalent of circuit breakers*"(Minsky et al., 1994, p. 2).

Another set of proposals were for the central bank and these are particularly relevant to the crises of 2007. Minsky also believed that Fed's willingness to intervene as the lender of last resort generates changes of behavior in financial markets. This calls for greater responsibility by the Fed for regulating financial markets to *"guide the evolution of financial institutions by favoring*

[17] Minsky's Stabilizing an Unstable Economy, however, offers an agenda for economic reform that is not consistent with Galbraith's position. An industrial policy promoting competitive markets is a major element in the Minsky program. In fact, in his first chapter, Minsky notes that Henry C. Simons's "A Positive Program for Laissez-Faire" contains "a model of political economy" that is (despite the passage of over fifty years) "still worth considering" [Minsky 1986a, p. 9, n. 7]. [1] Since Minsky is a major figure in the post-Keynesian movement, the connection between his policy recommendations and those of an individual associated with the so-called "Chicago School" of economics is one that deserves attention.

[18] "Minsky on the reregulation and restructuring of the financial system Will Dodd-Frank Prevent "It" from Happening Again"? April 2011

[19] http://findarticles.com/p/articles/mi_qa5437/is_4_35/ai_n28883985/

stability-enhancing and discourage instability-augmenting institutions and practices" (Minsky, 1986, p. 314). Greater reliance on prudential supervision of banks is one of his foremost recommendations.

Minsky also proposed several of reforms in the financial arena. He was approval of a more secure and prosperous international finance system, including stable exchange rates and an international lender of last resort (Minsky & Whalen, 1996, p. 16). His policy recommendations were designed to promote a successful form of capitalism and these policies meant to constrain instability through creation of various institutional ceilings and floors. While at the same time they would have to address the behavioral changes induced by reduction of instability. His proposals were completely outside the box of the *'invisible handwaves'* of free market ideologues.

5; Conclusion:. We can't have a capitalistic system free of crises, in the same vein It is not possible to set risks in financial markets to zero, however to curb these risks with a sensible economic policy is a probable. Many undesirable trends in financial markets are attributable to the dismantling of institutional restrictions on financing procedures which gave rise to mounting uncertainties and riskiness in financial markets .Current crises had told us that more *Laissez Faire* and re-introducing previously dismantled regulatory measures are not a suitable option to have more stable system. Markets needs institutions and an international institutional design that accords with the developed financial markets is the need of hour. Walter Bagehot truly said 135 years ago that "*Money does not manage itself*". The current crisis also teaches us important lessons that markets are unable to manage themselves when the question is of preserving the macroeconomic and financial stability. To contain the evils that market systems can inflict, capitalist economies must developed sets of institutions and authorities, which can be characterized as the equivalent of circuit breakers keeping in view the evolution of capitalistic economies in the last 30 years**.**

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